Reinsurance Market Outlook

April 2019
Executive Summary: Supply Weathering the Storm

Despite a reduction of 3 percent in total global reinsurance capital from year end 2017 to 2018, reinsurers continue to offer coverage and terms to insurers that show that reinsurance capital is weathering the storm of the prior few years’ catastrophe events. The market continues to see additional accretive buying opportunities for insurers. Even with this, the macro picture still shows that capital has increased by nearly 30 percent since 2011 across traditional and non-traditional capital sources and remains adequate for demand in all markets.

While traditional capital declined at year end 2018, the Aon Reinsurance Aggregate group of reinsurers showed positive signs as well. Overall combined ratio declined from 106.6 to 99.7 and valuation, return on equity, and investments showed increases year over year. Albeit including trapped capital for prior events, alternative capital remained strong for the year and is expected to regain momentum as losses are developed and finalized. Collateralized reinsurance continues to make up more than half the total capacity provided and catastrophe bonds had the second highest issuances in 2018.

Dominated globally by Japanese renewals, April 1 saw continued responsiveness from reinsurers who remained committed to the region despite ceded loss activity in 2018. Supply continued to cover demand and terms and conditions remain balanced for buyers against the backdrop of desired continuity with longer-term relationships.

With total catastrophe losses in 2017 and 2018 of over USD240 billion, the industry has experienced two significant catastrophe loss years and has responded positively to the needs of insureds. That said, a large share of the loss was retained by insurers as larger retentions coupled with smaller individual catastrophe events.

2019 has started with first quarter total catastrophe losses 47 percent lower than the recent 15-year average and 26 percent below the median. In addition, losses are the slowest start to a year the industry has experienced since 2013.

As we look forward to June and July renewals with heavy concentration in Florida and Australia, our expectation is that the industry will continue to find adequate supply in the aggregate with individual companies seeing renewals directly in response to exposure change, general loss experience, and a continued focus on loss estimation and creep from the 2017 and 2018 events.
Global Reinsurer Capital

Coming off peaks, but supply still strong

Aon estimates that global reinsurer capital stood at USD585 billion at December 31, 2018, down 3 percent relative to the end of 2017. This calculation is a broad measure of the capital available for insurers to trade risk with.

Traditional equity capital fell by USD28 billion, or 5 percent, to USD488 billion over the course of the year, driven mainly by macroeconomic factors. These included:

- Higher US interest rates, resulting in unrealized losses on bond portfolios;
- Strengthening of the US dollar (the conversion currency for international capital positions); and
- A stock market correction in the final quarter of 2018, with a recent accounting change introducing significant additional volatility to reported results.

Assets under management in the alternative capital sector rose by USD8 billion to USD97 billion (+9 percent) over the year to December 31, 2018. The total is shown gross of collateral trapped on contracts impacted by the major natural catastrophe losses in 2017 and 2018.

Exhibit 1: Change in global reinsurer capital

![Exhibit 1: Change in global reinsurer capital](image)

Sources: Company financial statements, Aon Business Intelligence, and Aon Securities Inc.

Global reinsurer capital remains resilient in the face of insured natural catastrophe losses aggregating to over USD240 billion over the last two years. Excess reinsurance capacity continues to exist, despite an increase in demand for reinsurance solutions on a global basis.

The proportion of the losses accruing to reinsurers has been relatively low, given the profile of the underlying events and the high retentions carried by large primary insurers. Furthermore, the reinsured portion has been spread around a much broader pool of investors than has historically been the case.
Traditional reinsurers continue to display strong risk-adjusted capitalization, as confirmed by rating agency and regulatory capital models. They utilize the capital markets to manage their gross exposures, carry significant budgets for net natural catastrophe losses and rely on investment returns to underpin their earnings. As a result, they have generally been able to trade through recent events without capital impairment.

The impact has been more significant in the alternative capital sector. Many investors have experienced some combination of lower than expected pricing, ‘creep’ on 2017 events and further losses in 2018 and the ongoing commitment of newer participants is being tested. This is affecting areas most dependent on this form of capacity, notably the retrocession market.

**Traditional capital**

The 23 companies forming Aon’s Reinsurance Aggregate (ARA*) represent a good proxy for the traditional capital sector. Upon conversion to US dollars, total reported equity stood at USD184 billion at December 31, 2018, a reduction of USD16 billion, or 8 percent, relative to the end of the prior year. Net income of USD9 billion was out-weighed by dividends and share buybacks of USD10 billion, foreign exchange losses of USD4 billion, unrealized investment losses of USD8 billion and other adjustments of USD3 billion.

**Exhibit 2: Change in ARA* total equity**

*The ARA constituents are Alleghany, Arch, Argo, Aspen, AXIS, Beazley, Everest Re, Fairfax, Hannover Re, Hiscox, Lancashire, MAPFRE, Markel, Munich Re, Partner Re, QBE, Qatar Insurance, Ren Re, SCOR, Sirius, Swiss Re, Third Point Re and W.R. Berkley.
The ARA reported strong premium growth in 2018, contributory factors being past M&A activity and increased reinsurance demand. Total P&C net premiums earned rose by 9 percent to USD154 billion.

The net combined ratio improved to 99.2 percent (2017: 106.6 percent), with natural catastrophe losses contributing 7.1pp (14.7pp) and favorable prior year reserve development providing 3.5pp (4.0pp) of benefit.

The ordinary investment yield showed a small uptick for the first time since the financial crisis to 2.8 percent (2017: 2.6 percent), while unrealized losses on bonds and equities reduced the overall return to 2.7 percent (3.8 percent).

Net income stood at USD9 billion (2017: USD6 billion), representing a return on equity of 4.2 percent (2.7 percent).

Exhibit 3: Reinsurance sector performance

Source: Company financial statements and Aon Business Intelligence
*Based on Aon's Reinsurance Aggregate
Alternative capital

After a surge in late 2017 and early 2018, headline growth in alternative capital has slowed, as the continuing entry of new funds has been partly offset by losses from catastrophe events and redemption requests from investors. The total of USD97 billion at December 31, 2018 is shown gross of collateral trapped on contracts impacted by the major natural catastrophe losses in 2017 and 2018.

Aon expects growth to continue once this area of the market has fully digested the losses incurred over the last two years. Many long-term investors have made good returns over time and the strategy of investing in insurance risk for diversification purposes in a low interest rate environment remains valid.

Exhibit 4: Alternative capital deployment

Catastrophe bond issuance totaled USD9.7 billion in 2018, making it the second most active year on record. Total limit outstanding is at a record high of more than USD30 billion and further high levels of activity have been seen in the first few months of 2019.

Exhibit 5: Catastrophe bond issuance
Manageable Global Natural Catastrophe Losses for Re/insurers

Preliminary data for the first quarter of 2019 indicates that the global insurance industry endured an active, yet manageable few months of natural catastrophe-related payouts. Through the first three months, the industry has tentatively sustained losses of USD7.1 billion. This estimate will increase as event losses are further realized, but is currently 47 percent below the recent 15-year average (2004-2018) of USD13.5 billion. When analyzing the losses on a median basis (USD9.6 billion), the 2019 losses were 26 percent lower.

Roughly USD4 billion of the insured losses were sustained in the United States; with five of the ten costliest Q1 events recorded in the country. A large portion of the losses were associated with a major spring storm system in mid-March that prompted extensive river flooding, severe convective storms, and synoptic wind-related damage across more than two-dozen states. Other costly insured loss events included a significant synoptic wind and severe convective storm event in late February which led to nearly USD1 billion in insured losses and a costly Polar Vortex event in late January into early February that led to a high volume of pipe bursts across the Midwest and Northern Plains.

The costliest event of first quarter, however, occurred in Europe. Windstorm Eberhard swept across parts of Western and Central Europe in early March and left an estimated USD1.1 billion industry cost to the hardest-hit countries of Germany, France, Belgium, Czech Republic, and the Netherlands. Windstorm Freya – another March storm – additionally cost insurers more than USD200 million.

Exhibit 6: Q1 Insured losses by year by type

Source: Aon’s Analytics Division in Reinsurance Solutions
Asia-Pacific’s costliest industry event occurred in Queensland. Torrential rainfall prompted catastrophic flooding in the greater Townsville region in early February, which has thus far prompted USD740 million in insured losses.

First quarter global catastrophe losses are historically the lightest of the year – with the most extreme outlier exception being 2011’s costly earthquake events in Asia-Pacific. Exhibit 7 shows that preliminary first quarter insured losses were below the 15-year average and median in all four of the major global regions: United States, Americas (Non-U.S.), Europe-Middle East-Africa (EMEA), Asia-Pacific (APAC). Public and private insurance entities in the United States are estimated to have paid out roughly USD4 billion in claims, which comprised 51 percent of the global total. EMEA represented 31 percent of the first quarter loss, with APAC equaling 14 percent. The Americas incurred 4 percent. It is worth repeating that each of these figures will inevitably increase as further claims are filed and processed.

**Exhibit 7: Insured losses by region**

![Exhibit 7: Insured losses by region](image)

Source: Aon’s Analytics Division in Reinsurance Solutions

The initial first quarter 2019 industry losses come at a time when public and private insurance entities continue to handle additional claims being filed and/or processed following some of the major events in 2018 Q3/Q4. High-cost events such as the 2018 California Wildfires, Typhoon Jebi, Hurricane Michael, and Hurricane Florence often result in a multi-year instance of loss development – or also known as “loss creep”. This prolonged period of loss evolution is typically caused by several scenarios including claims litigation and delayed claim filings by third-party contractors. Such instances are more common with large catastrophe events. In fact, loss development continues for hurricanes Harvey, Irma, and Maria and the California wildfires in 2017. The added loss development from 2018 events has now pushed last year’s annual insured loss payout toll to nearly USD95 billion.

Updates to the provided numbers are expected to continue throughout the year as losses are further developed. Aon will provide additional information in forthcoming Reinsurance Market Outlook documents.

To find the most up-to-date global catastrophe loss data for 2019, and other historical loss and climate data, please visit Aon’s Catastrophe Insight website: [http://catastropheinsight.aon.com](http://catastropheinsight.aon.com)
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